

## PROPOSED AGENCY RULE PROVIDES NEW INSIGHT INTO HVCRE RELIEF

OCTOBER 2018

In July, we [wrote](#) about the new treatment of HVCRE loans under the [Economic Growth, Regulatory Relief, and Consumer Protection Act](#) (the “Act”), which eased prior HVCRE requirements by subjecting fewer acquisition, development, and construction (ADC) loans to the heightened capital requirements mandated by the Basel III capital rules. Specifically, section 214 of the Act redefined an HVCRE-qualifying loan as a loan “secured by land or property that: (A) primarily finances, has financed, or refinances the acquisition, development, or construction of real property; (B) has the purpose of providing financing to acquire, develop, or improve such real property into income-producing real property; and (C) is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility.”<sup>1</sup>

On September 18, 2018, the Office of Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation released a [proposed rule](#)<sup>2</sup> meant to implement and interpret the changes to HVCRE treatment required by section 214 of the Act. The proposed rule is the first instance of agency guidance issued on section 214 and clarifies some of the more nuanced portions of the statute.

### DEFINITION OF HVCRE

The proposed rule mimics the definition of an HVCRE-qualifying loan in section 214.<sup>3</sup> The proposal clarifies that a loan “secured by land or property” is one where “the estimated value of real estate collateral at origination (after deducting all senior liens held by others) is greater than 50 percent of the principal amount of the loan at origination.”<sup>4</sup> Obviously, this would always be the case on pure real estate loans, but the limitation serves to prevent corporate credit facilities with real estate as “boot” collateral from being considered HVCRE. The addition also ensures consistent reporting by mirroring the definition of a loan “secured by real estate” in the context of preparing Consolidated Reports of Condition and Income or “Call Reports,” the same reports institutions use to estimate and report HVCRE loans.

The proposed rule also requires that the HVCRE determination be made only once per loan, at the facility’s origination. Moreover, the rule would add “other land loans” or loans “generally secured by vacant land except land known to be used for agricultural purposes” to the revised definition of HVCRE loans, again to facilitate consistency in the preparation and interpretation of Call Reports. Questions posed by the rulemaking agencies on the proposed rule suggest additional clarification may still be needed, as the agencies have invited comments on whether the phrase “secured by land or improved property,” among others, warrant further interpretation.<sup>5</sup>

### 15% EQUITY EXCEPTION

The primary change to the exceptions to HVCRE treatment under the proposed rule applies to the 15% cash equity exception for commercial real estate projects. First, the proposed rule redefines borrower-contributed capital to include real property or improvements, in addition

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<sup>1</sup> Pub. L. No. 115–174, § 214, 132 Stat. 1296, 1321 (2018).

<sup>2</sup> Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures, 83 Fed. Reg. 48990 (proposed Sept. 28, 2018) (to be codified at 12 C.F.R. pts. 3, 12, 324) [hereinafter “Proposed Rule”].

<sup>3</sup> See *supra* note 1.

<sup>4</sup> Proposed Rule, *supra* note 2, at 48993; Fed. Fin. Examination Council, Instructions for Preparation of Consol. Reports of Condition and Income: FFIEC 031 and FFIEC 041 GLOSSARY A-58, FFIEC 051 GLOSSARY A-74 (2018).

<sup>5</sup> *Id.*

to cash, unencumbered readily marketable assets, and out-of-pocket development expenses. The value of any real property contributed would be its “as completed” value,<sup>6</sup> less the aggregate amount of any liens on the property, except that the “as is” appraised value may be used when an “as completed” appraisal is not available, such as when purchasing raw land without short-term development plans.

Finally, the proposed rule states that for the 15% cash equity exception to apply to a project with multiple phases or stages, each phase or stage must have an individually appraised “as completed” value.<sup>7</sup>

## CONCLUSION

The proposed rule is a good step toward resolving some of the interpretive issues within section 214 of the Act. The agencies are accepting comments on the proposed rule until November 27, 2018.

## ADDITIONAL INFORMATION

For additional information, please contact:

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<sup>6</sup> 12 U.S.C. 3339 (2016).

<sup>7</sup> Proposed Rule, *supra* note 2, at 48995.